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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

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Commissioner

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Commissioner

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AZ CORP COMMISSION
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IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING ELECTRIC
RESTRUCTURING ISSUES

Docket No. E-00000A-02-0051

IN THE MATTER OF THE GENERIC
PROCEEDING CONCERNING THE ARIZONA
INDEPENDENT SCHEDULING
ADMINISTRATOR

Docket No. E-00000A-01-0630

STAFF'S CLOSING BRIEF

I. INTRODUCTION AND PROCEDURAL HISTORY.

On April 3, 2000, the Commission adopted Decision No. 62416, which adopted a Code of Conduct to govern Arizona Public Service Company's interactions with APS Energy Services, Inc., its competitive retail electric affiliate. In a subsequent proceeding, Staff identified certain potential deficiencies in that Code of Conduct. Specifically, Staff concluded that APS' existing Code of Conduct, which addresses APS' interactions with its **retail** affiliate, should be expanded to cover APS' interactions with its competitive **wholesale** electric affiliates. (Decision No. 65154 at 10). The Commission agreed with this conclusion, and in Decision No. 65154, APS was ordered to file for Commission review a revised code of conduct to address these issues.

On November 12, 2002, APS filed a revised Code of Conduct as required by Decision No. 65154. On August 13, 2003, Staff filed a report evaluating APS' filing, proposing modifications to that filing, and incorporating the standards of conduct developed in the Track B proceeding. (Ex. S-1 at 1 (Keene Direct); Ex. APS-1 at 5 (Guldner Direct)).

1 This proceeding was subsequently suspended because of APS' then-pending rate case. APS'
2 rate application included a request to acquire and rate base certain generation assets then held by
3 Pinnacle West Energy Corporation ("PWEC"), APS' competitive wholesale electric affiliate.
4 Recognizing that the Commission's decision regarding the PWEC assets could narrow the issues
5 presented by the code of conduct, the parties requested a stay of this proceeding. The ALJ
6 subsequently issued a procedural order delaying this proceeding until the conclusion of APS' rate
7 case. (Guldner Direct at 5-6).

8 In Decision No. 67744, the Commission approved with modifications a settlement of APS'
9 rate case proposed by all parties to that proceeding except one. Following the Commission's
10 issuance of that decision, the ALJ held a procedural conference and then adopted a procedural
11 schedule to govern further proceedings related to APS' proposed code of conduct. On July 29, 2005,
12 APS filed testimony proposing further revisions to its Code of Conduct. (Guldner Direct). On
13 September 30, 2005, Staff filed testimony in response to APS' July 29, 2005 filing. (Keene Direct).
14 On October 21, 2005, APS filed its rebuttal testimony. A hearing was held on November 14, 2005,
15 and Staff now files this Closing Brief in lieu of a closing statement.

16 **II. STAFF RECOMMENDS APPROVAL OF APS' PROPOSED CODE OF CONDUCT**
17 **SUBJECT TO CERTAIN MODIFICATIONS.**

18 Based upon its evaluation of this matter, Staff recommends that the Commission approve
19 APS' proposed code of conduct, subject to the following modifications:

20 1. The Commission's order in this matter should specifically find that Pinnacle West
21 Capital Corporation ("PWCC") falls within the definition of "Competitive Electric Affiliate" as set
22 forth in APS' proposed code of conduct. (Keene Direct at 3-4).

23 2. In APS' proposed definitions for "Competitive Retail Services" and "Noncompetitive
24 Services," the Commission should delete the phrase "in a Commission Rule" and replace it with the
25 phrase "by the Commission." (Keene Direct at 3, 5-6).

26 3. The Commission should delete the definition for "Commission Rule" from the
27 proposed code of conduct. (Tr. at 33-34¹).

28 ¹ E-00000A-02-0051, *et al.*, *In the Matter of the Generic Proceeding Concerning Electric Restructuring Issues*, Hearing Transcript, November 14, 2005.

1 4. The Commission should modify the proposed code of conduct to prohibit shared risk
2 management employees from serving as operating employees of either APS or its Competitive
3 Electric Affiliates. (Keene Direct at 7-8).

4 5. The proposed code of conduct should be further modified to prohibit any shared risk
5 management employee from acting as a conduit for improperly sharing information. (Keene Direct
6 at 7-8).

7 6. The Commission should require APS to add a definition for the term "Operating
8 Employee" to the code of conduct. (Keene at 8-9; Tr. at 58-60).

9 7. The Commission should modify the definition of "Shared Services" to indicate that
10 operating employees are excluded from providing shared services. (Keene Direct at 8).

11 8. The proposed code of conduct should also be modified to require each employee who
12 provides Shared Services to be trained regarding the Code of Conduct and to certify that he or she
13 will not act as a conduit for improperly sharing information. An electronic certification is acceptable,
14 but APS should allow Staff to review and approve the certification form. (Keene Direct at 9; Ex.
15 APS-2 at 3 (Guldner Rebuttal); Tr. at 31-33).

16 9. The proposed code of conduct should be modified to prohibit the same lawyer from
17 representing both sides in an arm's length transaction between APS and any of its Competitive
18 Electric Affiliates. (Keene Direct at 9-10; Tr. at 39-40).

19 10. The Commission should require APS to obtain the customer's prior **written**
20 authorization before APS may disclose Confidential Customer Information to others. (Keene Direct
21 at 10).

22 11. Typos appearing in Part Two, Sections III.B and C should be corrected. (Keene Direct
23 at 10; Tr. at 57-58).

24 12. The proposed code of conduct should describe the transactions that, under the
25 appropriate circumstances, need not be conducted at arm's length. (Keene Direct at 10-11; Guldner
26 Rebuttal at 9-10; Tr. at 36-38).

27 13. The proposed code of conduct should provide that the reports required by Part Two,
28 Section VIII shall be publicly available. (Keene Direct at 11).

1 14. Finally, the proposed code of conduct should state that the Commission's staff shall
2 select the independent monitor required by Part Four, Section III.B. (Keene Direct at 11; Guldner
3 Rebuttal at 3).

4 Some of these recommendations, such as numbers 11 and 13 on the preceding list, are self-
5 explanatory and/or unopposed by APS, and therefore do not merit further explanation. The
6 remainder are discussed in more detail below.

7 **A. The Commission's order in this matter should specifically find that Pinnacle**
8 **West Capital Corporation falls within the definition of "Competitive Electric**
9 **Affiliate" as set forth in APS' proposed code of conduct.**

10 APS has proposed the following definition for the term "Competitive Electric Affiliate":

11 Those affiliates of APS engaged in either Competitive
12 Retail Services or Competitive Wholesale Services.

13 (See Keene Direct at 3). The term "Competitive Wholesale Services" is defined as

14 the provision of energy products or services to the
15 wholesale electric market.

16 (See Keene Direct at 3). Staff believes that these definitions are appropriate; Staff is, however,
17 concerned about APS' application of these terms to Pinnacle West Capital Corporation ("PWCC"),
18 the holding company affiliate of APS. (Keene Direct at 3; Tr. at 11-12, 60-62). APS' testimony
19 specifically claims that PWCC does not fall within the definition of a "Competitive Electric Affiliate"
20 because PWCC does not market its existing wholesale contracts to APS for native load requirements.
(Guldner Rebuttal at 4). Staff disagrees with this conclusion.

21 It is undisputed that PWCC provides energy to wholesale customers. (Keene Direct at 3; Tr.
22 at 12). As APS witness Guldner acknowledged, PWCC provides full requirements service to
23 Unisource, the City of Williams, and Tohono O'odham; it enters contracts to buy and sell energy at
24 certain transmission delivery points; and it has 400-450 Megawatts of contracts with APS Energy
25 Services for load in California. (Tr. at 12-16). In addition, transactions related to balancing occur
26 between APS and PWCC. (Tr. at 12-13, 17). This testimony conclusively establishes that PWCC
27 provides energy products or services to the wholesale electric market, thereby placing PWCC
28 squarely within the definition of "Competitive Electric Affiliate."

1 According to APS, the Commission decided to reconsider APS' existing Code of Conduct in
2 order to address issues related to APS' interactions with Pinnacle West Energy Corporation, an APS
3 affiliate that owns generation assets.² APS witness Guldner reasoned that the Code of Conduct
4 should not be construed to include PWCC as a "Competitive Electric Affiliate" because the
5 Commission was originally concerned with APS' relationship with PWEC, not with PWCC.
6 (Guldner Direct at 2; Tr. at 16-17). But this argument overlooks the purpose behind expanding the
7 Code of Conduct, which is to ensure proper interaffiliate relationships between APS and its various
8 Competitive Electric Affiliates, no matter what form those affiliates may take.

9 The record of this proceeding demonstrates that PWCC provides wholesale electric service,
10 while PWEC appears to be downsizing. (Tr. at 12-21). To construe the Code of Conduct to apply to
11 PWEC, an entity that is scaling back its activities, but to ignore PWCC, an entity that clearly provides
12 electric service in the wholesale market, may circumvent the purpose of the code of conduct. PWEC
13 may have been the Commission's focus when it decided to re-examine APS' existing Code of
14 Conduct. That historical perspective, however, should not circumscribe this proceeding.

15 Finally, APS has not demonstrated that harm will result from construing PWCC as a
16 "Competitive Electric Affiliate." Although APS' rebuttal testimony attempts to describe certain
17 unintended consequences and other alleged harm that would result from this construction, APS was
18 unable at the hearing to identify the particular provisions in the proposed code of conduct, as
19 modified by Staff, that would create these results. (Guldner Rebuttal at 4-6; See also Tr. at 22-28, 63-
20 64). However, Staff is not opposed to adding provisions to clarify that dividends are not precluded
21 and that corporate governance is a shared service, although Staff is not convinced that these additions
22 are necessary. (Tr. at 63-64).

23 **B. APS' proposed code of conduct should be modified to ensure that Shared**
24 **Services are not used as a means to improperly share information or to provide**
APS' affiliates with unfair preferential treatment.

25 "Shared Services" are support services provided to various PWCC affiliates by PWCC itself
26 or by any of its affiliates. (Keene Direct at 6). Shared support staff may provide legal, accounting, or
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28 ² At the hearing, APS witness Guldner testified that PWEC has transferred its Arizona
generation assets to APS and is in the process of selling its Silver Hawk plant, which is located in
Nevada, to Nevada Power. (Tr. at 18-19).

1 data processing services to various affiliates, but do not participate in operating activities and
2 generally would not be in a position to give an affiliate an undue preference. (Keene Direct at 6).
3 Staff believes, however, that the code of conduct should be modified to ensure that Shared Services
4 cannot be used as a means of shielding inappropriate behavior.

5 **1. Modifications Related to "Operating Employees."**

6 First, the code of conduct should include the following definition for the term "Operating
7 Employee":

8 Employees, contractors, consultants, or agents who have
9 day-to-day duties and responsibilities for planning,
10 directing, organizing, or carrying out energy-related
11 operations. Operating employees include, but are not
12 limited to, generation employees, transmission employees,
13 and distribution employees. Operating employees do not
14 include employees performing support services in the areas
specifically identified in the definition of "Shared
Services." This definition is not intended to preclude APS
from providing trading desk services to PWCC as long as
the same employees do not provide the same services for
both entities.

15 (Keene Direct at 8-9; Tr. at 58-60). Further, the code of conduct should be modified to expressly
16 state that operating employees may not provide shared services. (Keene Direct at 8-9). Finally, the
17 code of conduct should specifically prohibit shared risk management employees from serving as
18 operating employees of either APS or its Competitive Electric Affiliates. (Keene Direct at 7-8).
19 Operating Employees are highly likely to have access to operational information that, if provided to
20 an affiliate, could give that affiliate an unfair advantage. These additional clarifications are designed
21 to prevent that potential abuse.

22 **2. Modifications Related to Legal Services.**

23 The proposed code of conduct should be modified to prohibit the same lawyer from
24 representing both sides in an arm's length transaction between APS and one of its Competitive
25 Electric Affiliates. (Keene Direct at 9-10; Tr. at 38-40). The proposed code of conduct should also
26 describe the transactions that, under the appropriate circumstances, need not be conducted at arm's
27 length. (Keene Direct at 10-11; Guldner Rebuttal at 9-10; Tr. at 36-38). These modifications are
28 intended to clarify the provisions of the code of conduct that relate to arm's length transactions.

1 **3. Other Modifications Related to Shared Services**

2 The proposed code of conduct should be further modified to prohibit any shared risk
3 management employee from acting as a conduit for improperly sharing information. (Keene Direct at
4 7-8). The proposed code of conduct should also be modified to require each employee who provides
5 Shared Services to be trained regarding the Code of Conduct and to certify that he or she will not act
6 as a conduit for improperly sharing information. (Keene Direct at 9; Guldner Rebuttal at 3; Tr. at 31-
7 33). Staff believes that the certification requirement can be satisfied by an electronic
8 acknowledgement. (See Tr. at 31-33, 62-63). However, Staff should have an opportunity to review
9 the certification form. (See Tr. at 33). These modifications are intended to ensure that shared service
10 employees will not improperly share information.

11 **C. The Commission Should Require APS To Obtain The Customer's Prior Written**
12 **Authorization Before APS May Disclose Confidential Customer Information to**
13 **Others.**

14 APS' proposed code of conduct requires only the customer's prior authorization, not the
15 customer's prior **written** authorization. (Keene Direct at 10; Guldner Rebuttal at 3; Tr. at 31-33).
16 APS' existing Code of Conduct requires written authorization, and Staff can find no justification for
17 deviating from this existing practice. Staff believes that a printed version of an electronic
18 authorization will satisfy this requirement. (Keene Direct at 10).

19 **D. The Definitions of "Competitive Retail Services" and "Non-Competitive**
20 **Services" Should Be Modified.**

21 Both of these definitions refer to determinations made in Commission rules. (Keene Direct at
22 5). It is possible, however, that the Commission may make a determination about these matters in a
23 proceeding other than a rulemaking, such as a rate case or a complaint. (Keene Direct at 5). The
24 Commission should therefore delete the phrase "in a Commission Rule" and replace it with the
25 phrase "by the Commission" to prevent these definitions from inappropriately limiting the impact of
26 relevant Commission determinations. (Keene Direct at 3, 5-6). If the Commission adopts this
27 proposed modification, it should also delete the definition for "Commission Rule" because it will no
28 longer be necessary. (Tr. at 33-34).

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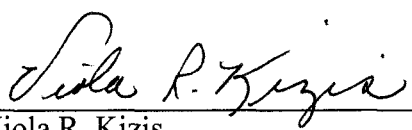
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